



FINANCIAL AND COMPLIANCE AUDIT REPORT

**Kansas Lottery
Fiscal Year 2003**

**A Report to the Legislative Post Audit Committee
By Berberich Trahan & Co., a certified public accounting firm
under contract with the Legislative Division of Post Audit
State of Kansas
December 2003**

Legislative Post Audit Committee

Legislative Division of Post Audit

The Legislative Post Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$8 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of government agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U. S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. These audit standards have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the representatives, three are appointed by the Speaker of the House and two are appointed by the House Minority Leader.

As part of its audit responsibilities, the Division is charged with meeting the requirements of the Legislative Post Audit Act which address audits of financial matters. Those requirements call for two major types of audit work.

First, the Act requires an annual audit of the State's financial statements. Those statements, prepared by the Department of Administration's Division of Accounts and Reports, are audited by a certified public accounting firm under contract with the Legislative Division of Post Audit. The firm is selected by the Contract Audit Committee, which comprises three members of the Legislative Post Audit Committee (including the Chairman and Vice-Chairman), the

Secretary of Administration, and the Legislative Post Auditor. This audit work also meets the State's audit responsibilities under the federal Single Audit Act.

Second, the Act provides for a regular audit presence in every State agency by requiring that audit work be conducted at each agency at least once every three years. Audit work done in addition to the annual financial statement audit focuses on compliance with legal and procedural requirements and on the adequacy of the audited agency's internal control procedures. These compliance and control audits are conducted by the Division's staff under the direction of the Legislative Post Audit Committee.

LEGISLATIVE POST AUDIT COMMITTEE

Representative John Edmonds, Chair
Representative Tom Burroughs
Representative Bill McCreary
Representative Frank Miller
Representative Dan Thimesch

Senator Derek Schmidt, Vice-Chair
Senator Bill Bunten
Senator Anthony Hensley
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Senator Chris Steineger

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LEGISLATURE OF KANSAS
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December 12, 2003

To: Members, Legislative Post Audit Committee

Representative John Edmonds, Chair	Senator Derek Schmidt, Vice-Chair
Representative Tom Burroughs	Senator Bill Bunten
Representative Bill McCreary	Senator Anthony Hensley
Representative Frank Miller	Senator Dave Kerr
Representative Dan Thimesch	Senator Chris Steineger

This report contains significant findings, conclusions, and recommendations from the completed financial-compliance audit of the Kansas Lottery covering fiscal year 2003. This audit was conducted by Berberich Trahan & Co., a certified public accounting firm under contract with the Legislative Division of Post Audit.

We would be happy to discuss this report with any legislative committees, individual legislators, or other State officials.

A handwritten signature in black ink that reads "Barbara J. Hinton". The signature is written in a cursive, flowing style.

Barbara J. Hinton
Legislative Post Auditor



Berberich Trahan & Co., P.A.

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INDEPENDENT AUDITORS' REPORT

Legislative Post Audit Committee
Kansas State Legislature:

We have audited the accompanying financial statements of the business-type activity of the Kansas Lottery, a component unit of the State of Kansas, as of and for the years ended June 30, 2003 and 2002, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. **An** audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. **An** audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Kansas Lottery are intended to present the financial position and the results of its operations and cash flows of the Lottery. They do not purport to, and do not present fairly, the financial position of the State of Kansas as of June 30, 2003 and 2002 and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activity of the Kansas Lottery, as of June 30, 2003 and 2002, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 16, 2003 on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 1 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Berberich Trahan & Co., P.A.

September 16, 2003

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

FINANCIAL AND COMPLIANCE AUDIT

Years Ended June 30, 2003 and 2002

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KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
FINANCIAL AND COMPLIANCE AUDIT
YEARS ENDED JUNE 30, 2003 AND 2002

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

INTRODUCTION

Year Ended June 30,2003

The accompanying report represents the results of the financial and compliance audit of the operations of the Kansas Lottery (Lottery) for the fiscal year ended June 30,2003.

The Lottery was created as an independent component unit of the State of Kansas to operate lottery games. It is administered by the Executive Director and the five members of the Lottery Commission appointed by the Governor. The Lottery is an enterprise fund wherein the activities are financed and operated through user charges similar to a private business enterprise.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Year Ended June 30,2003

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unqualified opinion on the financial statements of the Kansas Lottery.
2. No material weaknesses relating to the audit of the financial statements are reported in the report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards*.
3. No instances of noncompliance material to the financial statements of the Kansas Lottery were disclosed during the audit.

B. FINDINGS - FINANCIAL STATEMENT AUDIT

None.

C. PRIOR YEAR FINDINGS

None.

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE FISCAL YEAR ENDED JUNE 30, 2003

The following discussion and analysis of the Kansas Lottery's financial performance provides an overview of financial activities for the fiscal year ended June 30, 2003. Please read it in conjunction with the Lottery's financial statements, which follow the M D & A. The financial statements reflect only activities of the Kansas Lottery, a component unit of the State of Kansas.

Fiscal Year 2003 Financial Highlights

- Lottery sales for FY '03 were \$202,942,874 reflecting an increase of \$12,858,994 over those in FY '02 and were the highest since the Lottery began selling tickets in 1988. Total on-line sales were \$3,374,648 greater than the previous year. Specifically, Powerball, (a Multi-State Lottery (MUSL) game), sales were down \$947,710 because no jackpot reached the level of the \$295 million jackpot in the previous fiscal year. Super Kansas Cash, which was revamped in March, 2002, showed an increase of \$5,025,722 over the FY 2002 figures for the previous Kansas Cash game. Also, Keno and Winners Take All sales were down by a combined total of \$2,757,253 primarily because the Winners Take All game was discontinued in FY 2002 and replaced by the new 2by2 game. Compared to FY '02, the Lottery enjoyed a very good year of FY '03 Instant scratch ticket sales. Primarily because of printing considerably more instant games but in smaller quantities, the Lottery was able to offer new games to players on a more frequent basis during FY '03. This marketing strategy resulted in a substantial increase in instant ticket sales of \$9,041,158. The barcoded pull-tab tickets that were introduced in October of 2002, did not generate the revenue that was anticipated for FY '03, but still produced an increase of \$443,188 in sales over those in FY '02.
- The 2002 legislature again waived the requirement of monthly transfers to the State Gaming Revenues Fund (SGRF) being based on an amount of approximately 30% of sales. Instead, it originally set a minimum amount of \$59,000,000 with no less than \$4,500,000 being transferred in any one month. The \$59,000,000 was subsequently increased to \$61,500,000. Then, as a result of the Lottery receiving from the Multi-State Lottery (MUSL) a refund of \$1,077,005 from prize monies previously collected, the required final amount to be transferred to the SGRF was increased to \$62,500,000 for FY '03. Because of this and increased sales, transfers to the SGRF were \$7,299,570 more than the previous year. Transfers to the SGRF are capped at \$50 million. Overages become part of the State General Fund. Of the \$50 million, the first \$80,000 is earmarked for the Problem Gambling Grant Fund (PGGF), then 85% of the balance goes to the Economic Development Initiatives Fund (EDIF), 10% to prison reconstruction, and 5% to juvenile detention facilities.
- Income before operating transfers as a percent of sales increased by 0.3%. This is a result of sales having increased by 6.8% while total operating expenses only increased by 6.3%.

Using this Financial Report

This comprehensive financial annual report consists of a series of financial statements and reflects the self-supporting activities of the Kansas Lottery. The Statement of Net Assets provides information about the Lottery's assets and liabilities and reflects the Lottery's financial position as of June 30, 2003. The Statement of Revenues, Expenses and Changes in Net Assets reports the activity of selling lottery tickets and the related expenses for the 12-month period ended June 30, 2003. And lastly, the Statement of Cash Flows reflects the cash inflows and outflows attributed to the sales of lottery tickets for the same 12-month period.

Game Revenues

Revenues from the sale of lottery tickets for the fiscal year ended June 30, 2003, were the highest since the Lottery's first sales began in 1988. They were 6.8% or \$12,858,994 higher than the previous year, as indicated in the financial statements. FY '03 sales were \$202,942,874 compared to \$190,083,880 in FY '02. This was primarily the result of the combination of instant scratch ticket sales being higher than the prior year's by the significant amount of \$9,041,158 and the sales of the on-line Super Kansas Cash game having increased by \$5,025,722 from those in FY '02. Barcoded pull-tab tickets sales in FY '03 were up \$443,188 from the prior year.

Presented in millions of dollars, the following table compares Lottery sales by game type between fiscal years:

<u>Type of Game</u>	<u>2003</u>	<u>2002</u>	<u>Difference</u>	<u>Percentage</u>
Instant	\$79.4	\$70.4	\$9.0	12.8%
Pull-Tabs	4.8	4.4	0.4	9.1%
Powerball	52.7	53.7	-1.0	-1.7%
2by2	2.2	0.2	2.0	1000.0%
Super Kansas Cash	19.2	14.2	5.0	34.5%
Keno	39.0	39.9	-0.9	-2.3%
Pick 3	5.6	5.5	0.1	1.8%
Winners Take All	0.0	1.8	-1.8	-100.0%
Total	\$202.9	\$190.1	\$12.8	6.8%

Total Revenues

Other operating revenues consist of \$150 per retailer application fees and a \$10 per week per retailer lottery terminal satellite communication reimbursement charge. For the fiscal year ended June 30, 2003, these revenues amounted to \$996,799 compared to \$980,425 for the 2002 fiscal year.

Total revenues for FY '03 were \$203,939,673 in comparison to \$191,064,305 for FY '02, an increase of \$12,875,368 or 6.7%. As previously stated, the increase in revenues was primarily the result of the sales increases of on-line Super Kansas Cash and instant scratch tickets.

Major Expenses

Approximately \$131.2 million of the Lottery's total operating expenses of \$140.1 million for fiscal year 2003, were directly associated with lottery games. For FY '02, the game related expenses were \$123.5 million of a total \$131.8 million. These expenses include game prizes, retailer commissions, on-line game service bureau fees, telecommunications costs for on-line terminal satellite connections to retailer locations, and the cost of printing instant tickets. In January of 2003, the Lottery's on-line service vendor, GTech, completed installation of a satellite communication system for approximately 1,800 retailers' terminals. This new system is performing very well and has eliminated communication downtime from various causes such as storms, cables cut as a result of construction or street repair projects, etc. And of significant importance, it is considerably less costly than the phone line system used in the past. These expenses for FY '03 were a little more than \$841,000 less than those for FY '02.

The following table compares the game-related expenses between FY '03 and FY '02. The expenses are shown in millions of dollars:

<u>Type of Game-Related Expense</u>	<u>2003</u>	<u>2002</u>	<u>Difference</u>	<u>Percentage</u>
Game Prizes	\$107.7	\$98.9	\$8.8	8.9%
Retailer Commissions	11.7	11.0	0.7	6.4%
On-line Games Service Bureau	6.0	7.5	-1.5	-20.0%
Telecommunications Terminal Costs	2.7	3.5	-0.8	-22.9%
Instant Ticket Printing Costs	3.1	2.6	0.5	19.2%
Total	\$131.2	\$123.5	\$7.7	6.2%

On April 2, 2003, MUSL returned \$1,077,004 to the Kansas Lottery for its share of a jackpot that had remained unclaimed. These funds were properly credited against the Lottery's prize expense account. However, the overall increase in Game Prizes was the result of the substantial increase in sales compared to those in FY '02. The percentage decreases in On-line Games Service Bureau and Telecommunications Terminal Costs categories is the result of the more favorable contract rates negotiated with the Lottery's on-line vendor, GTech and the new satellite communications system also provided by GTech. Specifically, the On-line Games Service Bureau costs decreased by 19.7% and the Telecommunications Terminal Costs decreased by 24.0%. Instant Ticket Printing Costs for FY '03 were 21.0% greater than those in FY '02, reflecting higher printing costs for shorter runs and overall increased ticket sales.

Of the \$8.9 million of FY '03 operating expenses that were not game-related, \$3.6 million was for employees' salaries and wages, \$3.0 million was spent for games and promotional

advertising, and other administrative expenses accounted for \$2.1 million. In FY '02, these same expenses were \$3.6 million, \$2.5 million and \$1.9 million, respectively. The Lottery engaged in considerable additional promotional advertising for fiscal year 2003 in an effort to increase sales by participating in the weekly Powerball Game Show in Las Vegas; by conducting a number of second chance drawing giveaways that included a new Thunderbird and two new Harley Davidson pickup trucks; and by increasing player awareness of games and upcoming Lottery events. Thus, the substantial increase in expense of 20.1 %.

Other Financial Information

Total assets of the Lottery for the fiscal year ended June 30, 2003, were \$18.1 million. They consisted of cash for operations and prizes of \$9.1 million, accounts receivable from Lottery retailers for lottery tickets sales activity of \$7.4 million, instant ticket inventory totaling \$1.3 million, and property and equipment net of depreciation amounting to \$0.3 million.

Comparable figures at June 30, 2002, were \$15.2 million in total assets consisting of \$8.6 million in cash for operations and prizes, \$5.4 million in accounts receivable from retailers, \$0.8 million in instant ticket inventory, and \$0.4 million in net property and equipment.

Total liabilities of the Lottery at June 30, 2003, were \$11.2 million and were comprised of accounts payable and accrued liabilities of \$1.4 million, transfers due to the State Gaming Revenues Fund (SGFW) of \$4.8 million, and prize liability of \$4.9 million.

For the prior fiscal year end, total liabilities were \$9.7 million, of which, \$1.2 million was in accounts payable and accrued liabilities, \$4.0 million was due to the SGFW, and \$4.4 million was for prize liability.

Components of the Lottery's net assets at June 30, 2003, were its investment in capital assets of \$292,959 and unrestricted assets of \$6,596,106 for a total of \$6,889,065. For year-end FY '02 investment in capital assets was \$392,322 and unrestricted assets were \$5,160,782, for a total of \$5,553,104. The change in net assets between FY '03 and FY '02 were a decrease of \$99,363 in investment in capital assets and a \$1,435,324 increase in unrestricted assets reflecting a total net change of an increase of \$1,335,961. This outcome was mostly the result of the overall increase in sales revenue of \$12,858,994.

The following is a schedule of net assets:

<u>Net Assets</u>	<u>2003</u>	<u>2002</u>
Investment in Capital Assets	\$ 292,959	\$ 392,322
Unrestricted Assets	<u>6,596,106</u>	<u>5,160,782</u>
Total Net Assets	\$ 6,889,065	\$ 5,553,104

Transfers to the State Gaming Revenues Fund

For fiscal year 2003 the legislature waived the percentage of sales SGRF requirement for a minimum transfer of \$59,000,000 originally with a minimum monthly transfer of \$4,500,000. The \$59,000,000 was increased to \$61,500,000. After the Lottery received a refund of \$1,077,005 from the Multi-State Lottery (MUSL), the transfer was again increased to the final amount of \$62,500,000 for fiscal year 2003, reflecting an increase of \$7,299,570 compared to the FY 02 total transfers of \$55,200,430. Most of the difference is accounted for in the \$12,858,993 increase in sales in FY '03 and the additional \$1 million the legislature required the Lottery to transfer in fiscal year 2003.

Although all Lottery transfers are made to the SGRF, there is a \$50 million cap of that fund; therefore, any transfers in excess of \$50 million are subsequently transferred to the State General Fund (SGF). Of the \$50 million in the SGRF, the first \$80,000 is transferred to the Problem Gambling Grant Fund (PGGF). Then, of the balance remaining, 85% is transferred to the Economic Development Initiatives Fund (EDIF), 10% to the Correctional Institutions Building Fund (CIBF), and 5% to the Juvenile Detention Facilities Fund (JDFF). It should be noted that the Lottery has no control over or involvement in the transfers going out of the SGRF.

Budgetary Process and Highlights

As stated in the opening paragraph of this document, the Lottery is a component unit of the State of Kansas, and is a fully self-supporting entity and receives no monies from the State General Fund. The Lottery is required to annually submit by September 15th its budget to the Division of the Budget (DOB). The budget is prepared on a cash basis and is a revamping of the current year based on expenditure limitations approved by the legislature during the previous legislative session and, also, is a proposed budget for the next year that is considered the budget year. For example, after receiving the required approval of the Kansas Lottery Commission, on September 15, 2002, the budget submitted consisted of the redo of the fiscal year ending June 30, 2003, and a first-time submission for the fiscal year ending June 30, 2004.

The Lottery operates with both limited and unlimited expenditures. Limited expenditures consist of the normal administrative type expenditure such as payroll, rents, utilities, travel, audit services, various types of office and professional supplies, capital outlay, etc., and does include advertising expense. The unlimited expenditures consist of sales driven expenses or cost of sales expenses such as telecommunication costs for dedicated phone lines to the lottery terminals in retailer locations, instant scratch ticket printing costs, and fees paid to the on-line vendor.

In November of each year, the Division of the Budget (DOB) returns to the Lottery the DOB's recommendations that usually include some changes. The Lottery may appeal to the DOB and the Governor if it deems necessary. The final DOB recommendations are sent to the Governor for his/her submission to the newly convened legislature in January. The budget then goes through a lengthy legislative process and may have changed by the time it is finally approved in April.

For FY '03, the approved no-limit cost of sales budget was \$11,795,200 and the final limited administration budget amount was \$9,000,000. On a cash basis, actual expenses were \$11,936,093 and \$8,661,479, respectively.

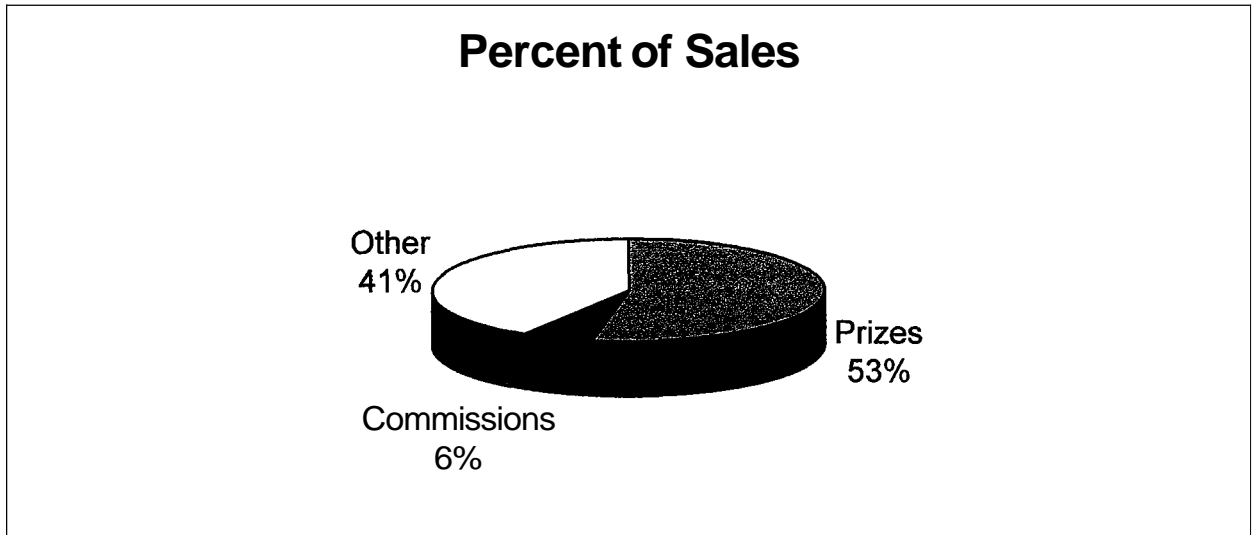
Fiscal Year 2004 Budget

For FY '04, the 2003 legislature has, once again, waived the previously required transfer rate based on a percentage of ticket sales in favor of a set minimum amount. This decision will afford the Lottery additional operating flexibility, and should result in increased ticket sales as was the case in FY 2003. The legislature is requiring the Lottery to transfer to the SGRF a minimum of \$62,773,000 plus the net proceeds of two instant scratch games designated to benefit veterans' causes. However, in addition to this, the Lottery was also required to transfer in July, '03, \$542,800 that represents the Lottery's portion of the Governor's mandatory 5.9 percent across the board budget cut. Also, another \$240,000 was transferred in July as required by the legislature. This was to help defray the State's costs of administering to the Lottery. Overall, the Lottery has set a sales goal of \$212.3 million for FY 2004. Administrative expenses for FY '04 have been decreased in the budget to \$8,724,400 as a result of the mandatory 5.9 percent cut.

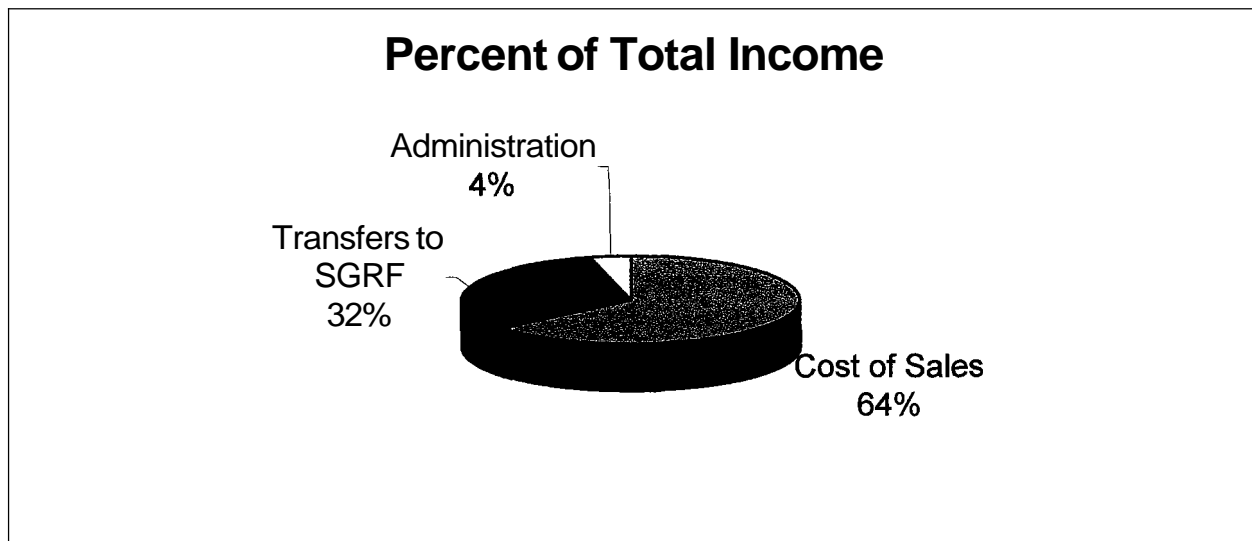
Contacting the Lottery's Financial Management

This management discussion and analysis report is designed to provide Kansas citizens, Kansas government officials, players, retailers and other interested parties with a general overview of the Lottery's financial activity for the fiscal year ended June 30, 2003 and to demonstrate the Lottery's accountability for the monies it received from its lottery ticket sales activity. Questions or comments about this report may be addressed to Gary Saville, the Kansas Lottery's Comptroller or Wayne Regnier, the Lottery's Fiscal Manager at 128 N. Kansas Avenue, Topeka, KS 66603.

**KANSAS LOTTERY
GRAPHS OF FINANCIAL HIGHLIGHTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**



To depict compliance with the 45% prize payment statute and the retailers' commissions rules.



To depict expenditures as a percentage of total income.

The Cost of Sales category includes prizes, commissions, service bureau, terminal phone/satellite lines, and instant ticket printing.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

BALANCE SHEETS

June 30, 2003 and 2002

	2003	2002
<u>ASSETS</u>		
Current assets:		
Cash (Note 2)		
Operating fund	\$ 8,499,410	\$ 8,041,405
Prize payment fund	563,230	512,521
Accounts receivable, net of allowance for doubtful accounts of \$210,049 and \$ 161,181	2,935,040	1,734,076
Accounts receivable - unbilled	4,478,886	3,678,943
Instant ticket game inventory	1,316,529	844,325
	<hr/>	<hr/>
Total current assets	17,793,095	14,811,270
	<hr/>	<hr/>
Capital assets:		
Property and equipment (Note 3)	3,616,758	3,521,999
Less accumulated depreciation	3,323,799	3,129,677
	<hr/>	<hr/>
Total long-term assets	292,959	392,322
	<hr/>	<hr/>
Total assets	\$ 18,086,054	\$ 15,203,592
	<hr/> <hr/>	<hr/> <hr/>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,435,517	\$ 1,226,886
Due to State Gaming Revenue fund (Note 7)	4,850,000	4,000,000
Prize liability	4,911,472	4,423,602
	<hr/>	<hr/>
Total current liabilities	11,196,989	9,650,488
	<hr/>	<hr/>
Net assets:		
Investment in capital assets	292,959	392,322
Unrestricted	6,596,106	5,160,782
	<hr/>	<hr/>
Total net assets	6,889,065	5,553,104
	<hr/>	<hr/>
Total liabilities and net assets	\$ 18,086,054	\$ 15,203,592
	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes to financial statements.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS

Years Ended June 30, 2003 and 2002

	2003	2002
Operating revenues:		
Net game revenues (Note 9)	\$ 198,228,257	\$ 186,211,309
Net unsettled revenues (Note 9)	4,714,617	3,872,571
Retailer fees and miscellaneous income	67,040	52,989
Phone reimbursements	929,759	927,436
	<hr/>	<hr/>
Total operating revenues	203,939,673	191,064,305
	<hr/>	<hr/>
Operating expenses:		
Game prizes (Note 9)	107,660,534	98,963,631
Retailer commissions (Note 9)	11,743,157	10,970,972
Advertising	2,987,502	2,487,318
Cost of instant tickets	3,110,802	2,570,005
Depreciation	194,122	258,838
Professional services	55,234	83,940
On-line games service bureau	6,019,461	7,497,073
Salaries and benefits	3,604,866	3,579,747
Telecommunications	2,660,874	3,502,403
Other administrative expense	2,067,160	1,879,794
	<hr/>	<hr/>
Total operating expenses	140,103,712	131,793,721
	<hr/>	<hr/>
Operating income before transfers	63,835,961	59,270,584
Transfers out (Note 8):		
State Gaming Revenue fund	62,500,000	55,200,430
	<hr/>	<hr/>
Net income	1,335,961	4,070,154
		<hr/>
Net assets, beginning of year		914,120
Correction for equipment not recorded and adjustment of accounts payable balances in prior year (Note 1)		568,830
		<hr/>
Net assets, beginning of year as restated	5,553,104	1,482,950
	<hr/>	<hr/>
Net assets, end of year	\$ 6,889,065	\$ 5,553,104
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See accompanying notes to financial statements.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

STATEMENTS OF CASH FLOWS

Years Ended June **30,2003** and 2002

	2003	2002
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 201,938,766	\$ 190,613,076
Cash paid for prizes, commissions, and other expenses	(139,685,293)	(132,308,380)
Net cash provided by operating activities	<u>62,253,473</u>	<u>58,304,696</u>
Cash flows from noncapital financing activities:		
Transfers to State Gaming Revenue fund	(61,650,000)	(56,494,603)
Cash flows from capital and related financing activities:		
Purchase of equipment	(94,759)	(64,595)
Net increase in cash	508,714	1,745,498
Cash, beginning of year	8,553,926	6,808,428
Cash, end of year	<u>\$ 9,062,640</u>	<u>\$ 8,553,926</u>
Reconciliation of operating income before transfers to net cash provided by operating activities:		
Operating income before transfers	\$ 63,835,961	\$ 59,270,584
Adjustments to reconcile operating income before transfers to net cash provided by operating activities:		
Depreciation	194,122	258,838
Changes in operating assets and liabilities:		
Accounts receivable	(2,000,907)	(451,229)
Ticket inventory	(472,204)	42,556
Accounts payable and accrued liabilities	208,631	(303,467)
Prize liability	487,870	(512,586)
Net cash provided by operating activities	<u>\$ 62,253,473</u>	<u>\$ 58,304,696</u>

See accompanying notes to financial statements.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS

June 30, 2003 and 2002

1 - Summary of Significant Accounting Policies

Reporting Entity

In November 1986, a constitutional amendment was approved by the Kansas voters authorizing a State Lottery. During the 1987 Legislative session, the State Legislature adopted the Lottery Act (the Act), and created the Kansas Lottery (the Lottery) as an independent component unit of the State of Kansas to operate lottery games. The 2001 Legislative session continued the Lottery until June 30, 2008. The Kansas Lottery Act abolishes the Lottery on July 1, 2008, unless the Legislature reaches an affirmative vote to continue the Lottery during the 2007 Legislative session.

The Lottery was organized on March 19, 1987 and commenced administrative operations on May 21, 1987 but was strictly in the developmental stage through fiscal year 1987. Instant win ticket games began November 12, 1987. On February 2, 1988, the Lottery began participating in Lotto America, a multi-state on-line game now called Powerball. Additional games offered by the Lottery include Kansas Cash, Keno, Pick 3, and 2 By 2, and Pull Tabs.

The Lottery operates under the direction of the Executive Director of the Lottery and a five-member Lottery Commission appointed by the Governor. The Commission advises the Executive Director and reviews and approves Lottery games, rules, and regulations.

Basis of Presentation

The Lottery is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the intent is that the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or where the periodic determination of net income is considered appropriate. In reporting its financial activity, the Lottery applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements, Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Basis of Accounting

The financial statements of the Lottery have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of accounting refers to when revenues, expenses and the related assets and liabilities are recognized in the accounts and reported in the financial statements. Measurement focus refers to what is being measured. The financial statements are prepared on the accrual basis of accounting and on an economic resources measurement focus in accordance with GAAP.

The Lottery does not distinguish between operating revenues and expenses and nonoperating items, as the Lottery considers all items to be of an operating nature.

Revenue Recognition

Lottery games are sold to the public by contracted retailers. The Lottery utilizes an on-line instant ticket validation system. This system utilizes a bar code system to activate, track and validate instant win tickets which are consigned to retailers. The activated and unsettled instant win ticket packets are reflected in revenues in the current period and are carried on the balance sheet as accounts receivable - unbilled. Consigned instant win ticket packets at the retailer that have not been activated are reflected on the financial statements in ticket inventory at original cost.

Certain instant ticket games include tickets which entitle the holder to exchange the ticket for another ticket ("free tickets"). Such tickets are deemed to be replacements and, therefore, are not included in sales.

Pull tab game revenue is recognized when the games are delivered to the retailers. Pull tab games were replaced by new instant pull tab games in October 2001. The instant pull tab games are accounted for in the same manner as instant games. Pull tabs are purchased without a right of return.

On-line game revenue is recognized in the period in which tickets are sold.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Retailer Commissions

Retailers receive a commission of five percent of ticket sales, which is recognized as expense when sales are recorded. In addition to the five percent commission on sales, retailers receive a one percent cashing bonus for redeeming prizes that are less than \$600, an additional one percent for redeeming Keno prizes and a bonus of one percent on instant and on-line tickets they sell that win over \$600, with a minimum of \$ 10 and a maximum of \$ 100 for each prize.

Retailers also receive a bonus of \$ 10,000 for selling the Powerball jackpot ticket and a \$ 1,000 bonus for selling a Kansas Cash jackpot ticket or a \$ 100,000 Powerball ticket.

Retailer Fees

Licensed retailers are charged a one-time fee for the right to sell lottery tickets. Fees are recorded as income when received by the Lottery.

Accounts Receivable

Accounts receivable represent amounts to be collected from retailers and are shown as net of allowance for doubtful accounts. The allowance for doubtful accounts is based on an analysis of accounts receivable, which considers the age of the accounts and current economic conditions.

Ticket Inventory

Instant ticket game inventory consists of tickets stored in the main and regional warehouses, trunk stock of District Managers and consigned and inactivated tickets at the retailer. Inventories are carried at cost based on the specific identification method. Tickets are charged to cost of sales when activated by a licensed retailer. Unsold tickets are charged to cost of sales at the end of each instant ticket game.

Property and Equipment

Property and equipment costing over \$ 5,000 are carried at cost less accumulated depreciation. Depreciation is computed on the straight-line basis using estimated useful lives of three to five years.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Prize Liability

The Act states "as nearly as practical, an amount equal to not less than 45 percent of the total sales of lottery tickets or shares, computed on an annual basis, shall be allocated for payment of Lottery prizes." This amount is recognized and accrued as a prize liability. Actual prizes paid are treated as a reduction of the prize liability.

Prize expense for instant ticket games is recorded based on the predetermined prize structure for each game. Since instant prize tickets are randomly distributed throughout the tickets, there will be differences between amounts accrued and the amounts actually paid if all tickets for a game have not yet been sold. Prizes which are not claimed within 180 days after the termination of each game remain in the prize pool, and future prizes will be increased accordingly through special prize promotions.

Prize expense for on-line games is recorded based on ticket sales. Prizes which are not claimed within one year after the drawing remain in the prize pool, and future prizes will be increased accordingly through special prize promotions.

Compensated Absences

Under the terms of the Lottery's personnel policy, employees are granted vacation and sick leave in varying amounts based upon length of service. In the event of termination or separation, an employee is generally paid for accumulated vacation up to 144 hours for service less than five years; 176 hours for service between five and ten years; 208 hours for service between ten and fifteen years; and 240 hours if service exceeds fifteen years [K.A.R. 1-9-41. Accordingly, it is the Lottery's policy to record vacation pay as an expense as it is earned. The amount of earned but unused accumulated vacation is included as an accrued liability in the accompanying financial statements.

Retiring employees are paid a portion of their accumulated sick leave in excess of 100 or more days, depending upon the total number of accumulated days and years of service. The minimum payable is 30 days, and the maximum is limited to 60 days. The amount of earned but unused accumulated sick leave is paid from the State Leave Payment Reserve fund to which the Lottery makes monthly contributions.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Budget

The Lottery prepares an annual budget of expenses which is approved by the State Legislature of Kansas. Any changes in the budget must also be approved by the State Legislature. Such budgets are adopted on a cash plus encumbrance basis, which differs from accounting principles generally accepted in the United States of America. Encumbrances represent commitments relating to unperformed contracts for goods or services. All budgeted, unencumbered funds lapse at fiscal year-end.

Cash Equivalents

For purposes of reporting cash flows, cash includes cash on hand and in banks and amounts deposited with the Treasurer of the State of Kansas.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Prior Period Adjustment

In prior years, the Lottery did not record equipment purchased by its on-line gaming system services contractor on the Lottery's behalf. The 2002 financial statements have been restated to record the equipment and related depreciation expense resulting in a \$ 57,020 decrease in net income for the year ended June 30, 2002. The effect on beginning net assets as of July 1, 2001 is an increase of \$223,838.

In prior years, the Lottery recorded encumbrances as accounts payable. The 2002 financial statements have been restated to adjust accounts payable balances resulting in a \$ 548,214 increase in net income for the year ended June 30, 2002. The effect on beginning net assets as of July 1, 2001 is an increase of \$344,992.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - Cash

Cash, other than petty cash and imprest funds, is part of the common cash pool in the State Treasury. The Pooled Money Investment Board invests funds of the common cash pool in excess of that necessary to meet current obligations. Collateral is required for deposits made by the common cash pool that are not covered by federal deposit insurance. The fair value of the collateral must equal 100 percent of the uninsured deposit and is held by the State Treasurer or an independent third party in the State Treasurer's name. At least monthly, the State Treasurer determines that the fair value of the collateral is adequate. Earnings on investments are retained by the State of Kansas. At June 30, 2003 and 2002, the Lottery's share in the State's common cash pool was \$ 8,898,835 and \$ 8,368,507 respectively.

The Lottery maintains its imprest fund cash in one commercial bank. The amount on deposit at June 30, 2003 exceeded the insurance limits of the Federal Deposit Insurance Corporation by approximately \$70,000.

3 - Capital assets

Capital assets, which include property and equipment, are defined by the State of Kansas as assets with an initial, individual cost of more than \$ 5,000. Such assets are recorded at historical cost. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - Capital Assets (Continued)

Such property and equipment consisted of the following at June 30, 2003 and 2002:

Fiscal Year 2003:	Beginning Balance	Increases	Decreases	Ending Balance
Data processing equipment	\$ 2,552,882	\$ 86,950	\$ -	\$ 2,639,832
Office furniture, fixtures, and equipment	775,420			775,420
Vehicles and other	193,697	7,809		201,506
	<u>\$ 3,521,999</u>	<u>\$ 94,759</u>	<u>\$ -</u>	<u>\$ 3,616,758</u>
Accumulated depreciation	<u>\$(3,129,677)</u>	<u>\$ (194,122)</u>	<u>\$ -</u>	<u>\$(3,323,799)</u>
Fiscal Year 2002:	Beginning Balance	Increases	Decreases	Ending Balance
Data processing equipment	\$ 2,541,793	\$ 11,089	\$ -	\$ 2,552,882
Office furniture, fixtures, and equipment	775,420			775,420
Vehicles and other	140,191	53,506		193,697
	<u>\$ 3,457,404</u>	<u>\$ 64,595</u>	<u>\$ -</u>	<u>\$ 3,521,999</u>
Accumulated depreciation	<u>\$(2,870,839)</u>	<u>\$ (258,838)</u>	<u>\$ -</u>	<u>\$(3,129,677)</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

4 - Commitments

The Lottery leases office and warehouse space in both Topeka and Great Bend under operating leases from unrelated parties. Minimum future lease payments by fiscal year are as follows:

2004	\$ 414,340
2005	414,340
2006	414,340
2007	414,340
2008	414,340
Thereafter	<u>4,800</u>
	<u><u>\$ 2,076,500</u></u>

It is anticipated that as leases expire they will be replaced with new leases.

The Lottery incurred office and warehouse rental expense of approximately \$389,900 and \$358,000 under operating leases for the years ended June 30, 2003 and 2002, respectively.

The Lottery has contracted with a service bureau which provides computer services for on-line games and instant-win validation. The duration of the current contract is through June 30, 2008. Future fees, calculated on cumulative net on-line sales (gross, less cancels, coupons, free tickets and rejected tickets) through June 30, 2008, are 5.12 percent, with no fee for validation of instant win games through June 30, 2008.

5 - Contingencies

Zero Coupon Bonds

Lotto America and Powerball prizes awarded to the grand prize winner are payable in annual installments over 20 years. Prizes awarded to grand prize winners after November 2, 1997 are payable in annual installments over 25 years. The first payment is made by the Lottery within weeks of the drawing. Treasury zero coupon bonds that provide payments corresponding to the Lottery's obligation to these winners are purchased by the Multi-State Lottery (MUSL). MUSL holds these bonds in an account for the Lottery, cashes the bonds when due, and wires the money to the Lottery on or before the anniversary date of the winner. The investments and related prize liabilities for winners of these games are excluded from these financial statements.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

5 - Contingencies (Continued)

Zero Coupon Bonds (Continued)

Prior to 1998, the MUSL had purchased zero coupon bonds for the Lottery to fund future installment payments aggregating \$224,979,000. The total purchase price of these bonds was \$ 117,288,823. During fiscal year 2001, a cash out option was offered to these prize winners as a result of Congressional changes in the United States Internal Revenue Code of 1986, as amended, specifically Section 451(h). These cash out options were taken by six prize winners in the amount of approximately \$43,500,000.

Total future installments outstanding at June 30, 2003 and 2002 are \$ 44,861,000 and \$49,897,000, respectively.

MUSL Prize Reserves

The Lottery is a member of the MUSL, which consists of 25 state and district lotteries. MUSL operates the Powerball game, a semiweekly 5 out of 53 plus 1 out of 42 lotto game. The grand prize is determined on a parimutuel basis, payable over a set number of years. A cash option became available on November 2, 1997. The remaining prizes are set cash prizes. Each MUSL member sells Powerball tickets through its retailers and makes weekly wire transfers to the MUSL. The weekly transfer amount consists of 50 percent of weekly sales less actual set cash prizes paid by the Lottery. The prize pool for all Powerball prize categories consists of 50 percent of each drawing period's sales, until the grand prize is funded to the annuitized amount guaranteed by the MUSL. When the grand prize fund reaches the guaranteed annuitized amount, then 48 percent of sales becomes part of the prize pool and 2 percent of sales is placed in the prize reserve fund. The MUSL has placed a \$75,000,000 cap on the prize reserve account and a \$25,000,000 cap on the set prize reserve account. Once the prize reserve accounts exceed the designated caps, the excess will become part of the prize pool. The prize reserve account serves as a contingency reserve fund to protect the MUSL in case of unforeseen, but valid liabilities for grand prize claims or for set prizes. The unreserved account serves as a MUSL operations and Powerball promotions expense account.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

5 - Contingencies (Continued)

MUSL Prize Reserves (Continued)

The prize reserve and set prize reserve account monies are refundable to MUSL members if the MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 2003 and 2002, the prize reserve account had a balance of \$ 63,909,373 and \$ 52,725,253, respectively, of which the Lottery's contribution was \$2,413,823 and \$2,164,128, respectively. The set prize reserve at June 30, 2003 and 2002 had a balance of \$24,782,005 and \$ 25,732,874, respectively, of which the Lottery's contribution was \$757,834 and \$ 1,007,528, respectively. The unreserved account at June 30, 2003 and 2002 had a balance of \$ 11,906,474 and \$ 13,855,778, respectively, of which the Lottery's contribution was \$ 67,818 and \$ 219,212, respectively.

Win for Life

The Lottery purchases annuity contracts from insurance companies in the name of the Win for Life game jackpot prize winners. In the event an insurance company defaults on its payments, the Kansas Life and Health Insurance Guarantee Association (KLHIGA) will make the payments. The KLHIGA was statutorily created, as set forth in K.S.A. 40-3008, subsection (o), to provide coverage in the event an insurance company defaults. The Lottery remains contingently liable for the payment of the lifetime prizes in the event the insurance companies and the KLHIGA fail to meet their obligation.

Annuity contracts have been purchased for lifetime prize payments. The approximate remaining prize payments are \$ 607,500. Prize payments are due in varying amounts through September 2047 or the life of the individuals.

Litigation

There are a number of claims and/or lawsuits to which the Lottery is a party. The Lottery management and legal counsel anticipate that the potential claims against the Lottery would not materially affect the financial position of the Lottery.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

6 - Risk Management

The Lottery's risk management activities for workers' compensation and unemployment are recorded in the State Workers' Compensation Self-Insurance Fund and the Employment Security Fund, funds of the State of Kansas. The Lottery contributes to these funds based upon annual assessed rates.

Employees are offered various health insurance coverage programs of the State; the Lottery's contribution toward single member coverage ranges from 85 percent to 97 percent, based on salary level and tobacco usage of the employee.

State agencies are not allowed to purchase or carry insurance on any property owned by the State or its agencies, except as expressly and specifically authorized by statute. Currently, none of the exceptions apply to property of the Lottery. The State has had no problem in resolving losses in the past through utilization of resources available at the time the loss occurred. The Lottery retains liability for property and equipment damage.

Tort claims involving Lottery employees are subject to the Kansas Tort Claims Act (K.S.A. 75-6101, *et seq.*).

Employees' faithful performance is covered by commercial insurance. There has been no significant reduction in insurance coverage.

7 - Transfers

Pursuant to the Act, the Director of Accounts and Reports of the State of Kansas shall transfer monies in the Lottery operating fund to the State Gaming Revenue fund, at least monthly, in an amount equal to the monies in such fund in excess of those needed for payment of Lottery expenses, payment of compensation to retailers and transfers to the prize payment fund as certified by the Executive Director of the Lottery. For the year ended June 30, 2003, the State Legislature mandated that transfers to the fund total \$ 62,500,000. For the year ended June 30, 2002, the accumulated year-to-date transfers were required to be in an amount not less than 30 percent of total revenues from the sales of Lottery tickets during fiscal year 2002. Transfers to the State Gaming Revenue fund of \$ 62,500,000 and \$ 55,200,430 were made for the years ended June 30, 2003 and 2002, respectively. For the year ended June 30, 2002, transfers were based on accrual basis net game revenues.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

8 - Pension Plan

Plan description. The Lottery participates in the Kansas Public Employees Retirement System (KPERS), a cost-sharing, multiple-employer defined benefit pension plan as provided by K.S.A. 74-4901, *et seq.* KPERS provides retirement benefits, life insurance, disability income benefits, and death benefits. Kansas law establishes and amends benefit provisions. KPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to KPERS (611 South Kansas Avenue, Suite 100; Topeka, Kansas 66603-3803) or by calling 1-800-228-0366.

Funding policy. K.S.A. 74-4919 establishes the KPERS member-employee contribution rate at four percent of covered salary. Eligible employees are considered full-time with one year of service. The employer collects and remits member-employee contributions according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rate be determined annually based on the results of an annual actuarial valuation. KPERS is funded on an actuarial reserve basis. State law sets a limitation on annual increases in the contribution rates for KPERS employers. The employer rates established by statute for calendar years 2003 and 2002 are 4.38 and 4.18 percent, respectively. The Lottery contributions to KPERS for the years ending June 30, 2003, 2002 and 2001, were approximately \$ 118,000, \$ 122,000 and \$ 111,000, respectively, equal to 100% of the statutorily required contributions for each year.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

9 - Operating Segment Information

Operating segment information by game is as follows:

Year Ended June 30, 2003									
	instant	Pull Tabs	Power- ball	2 by 2	Kansas Cash	Keno	Winners Take All	Pick 3	Total
Sales, net	\$ 79,422,774	\$ 4,809,795	\$ 52,749,897	\$ 2,189,030	\$ 19,201,491	\$ 38,973,961	\$ -	\$ 5,595,926	\$ 202,942,874
Prizes, net	(45,759,238)	(3,221,601)	(24,811,748)	(1,098,976)	(9,004,517)	(21,077,976)		(2,686,478)	(107,660,534)
Retailer commissions	(4,873,829)	(311,194)	(2,928,075)	(124,527)	(1,053,422)	(2,144,238)		(307,872)	(11,743,157)
Gross margin	\$ 28,789,707	\$ 1,277,000	\$ 25,010,074	\$ 965,527	\$ 9,143,552	\$ 15,751,747	\$ -	\$ 2,601,576	\$ 83,539,183

Year Ended June 30, 2002									
	Instant	Pull Tabs	Power- ball	2 by 2	Kansas Cash	Keno	Winners Take All	Pick 3	Total
Sales, net	\$ 70,381,616	\$ 4,366,607	\$ 53,697,607	\$ 189,013	\$ 14,175,769	\$ 39,928,293	\$ 1,802,921	\$ 5,542,054	\$ 190,083,880
Prizes, net	(37,760,321)	(2,924,925)	(25,740,054)	(94,507)	(6,804,369)	(22,040,418)	(883,431)	(2,715,606)	(98,963,631)
Retailer commissions	(4,550,887)	(282,345)	(2,871,138)	(10,106)	(751,245)	(2,116,001)	(95,549)	(293,701)	(10,970,972)
Gross margin	\$ 28,070,408	\$ 1,159,337	\$ 25,086,415	\$ 84,400	\$ 6,620,155	\$ 15,771,874	\$ 823,941	\$ 2,532,747	\$ 80,149,277

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS
(Continued)

10 - Budget and Actual Comparison

As discussed in Note 1, the Lottery prepares an annual budget of expenses on a cash plus encumbrance basis. Expenses may not exceed budgeted amounts for total operating expenses or certain line items.

At June 30,2003, there were only two separate line items budgeted: Kansas Incentive Program (**KSIP**) appropriations and official hospitality. Actual expenses were \$ 130,875 for KSIP appropriations out of the budgeted amount of \$273,028. Actual expenses for official hospitality were \$2,241 out of the budgeted amount of \$ 5,000 on a budgetary basis for the year ended June 30,2003.

The following table presents a comparison of the legally adopted budget with actual data on a budgetary basis for years ended June 30,2003 and 2002:

	<u>2003</u>	<u>2002</u>
Operating expenses excluding expenses for game prizes, retailer commissions, on-line games service bureau and on-line communications and ticket printing		
Actual, budget basis	<u>\$ 7,607,463</u>	<u>\$ 8,113,715</u>
Budget	<u>\$ 9,273,028</u>	<u>\$ 8,585,278</u>

Significant differences in actual expenses on a budget basis compared to actual expenses on a *GAAP* basis include game prizes, retailer commissions, on-line games service bureau, on-line communications expenses, and ticket printing, which are nonbudgeted expenses.



Berberich Trahan & Co., P.A.

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING IN CONNECTION WITH AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Legislative Post Audit Committee
Kansas State Legislature:

We have audited the financial statements of the Kansas Lottery as of and for the year ended June 30, 2003, and have issued our report thereon dated September 16, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Kansas Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Kansas Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Lottery in a separate letter dated September 16, 2003.

This report is intended solely for the information and use of management and the Legislative Post Audit Committee of the Kansas State Legislature and is not intended to be and should not be used by anyone other than those specified parties,

Berberich Trahan & Co., P.A.

September 16, 2003



KANSAS LOTTERY

ED VAN PETTEN, EXECUTIVE DIRECTOR

KATHLEEN SEBELIUS, GOVERNOR

October 7, 2003

Ms. Karen L. Keehn. CPA
Shareholder
Berbench Trahan & Co., P. A.
3630 SW Burlingame Road
Topeka, KS 66611-2050

Dear Ms. Keehn:

We have reviewed your draft of the Financial and Compliance Audit Report for the Kansas Lottery for the fiscal year ended June 30, 2003 and we concur with the results of the audit.

We are very pleased that *there* were no "findings" to be reported.

As in the past, we certainly appreciate the professional manner in which you and your staff worked with our staff in the audit preparation.

Sincerely,

A handwritten signature in cursive script that reads "Ed Van Petten".

Ed Van Petten
Executive Director